No. 95-559

In The

Supreme Court of the United States

October Term, 1995

DOCTOR'S ASSOCIATES, INC. and NICK LOMBARDI,

Petitioners,

vs.

PAUL CASAROTTO and PAMELA CASAROTTO,

Respondents.

On Writ of Certiorari to the Supreme Court of Montana

BRIEF OF AMICUS CURIAE KAISER FOUNDATION HEALTH PLAN, INC. IN SUPPORT OF PETITIONERS

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TABLE OF CONTENTS

TABLE OF CITATIONS

Cases Cited:

Contents

Contents

Statutes Cited:

Contents

PARTIES' CONSENT FOR FILING THIS BRIEF AS AMICUS CURIAE

Kaiser Foundation Health Plan, Inc. ("Kaiser") submits this brief in support of petitioners Doctor's Associates, Inc. and Nick Lombardi. Both petitioners and respondents have consented to the filing of this brief pursuant to Rule 37 (3)(a).

I. AMICUS' INTEREST AND PERSPECTIVE

Kaiser's interest in this case is twofold. First, the arbitration provision in Kaiser's numerous contracts with employers, union welfare funds, and individuals is being challenged pursuant to a recently enacted California statute that requires a specialized arbitration notice similar to that imposed by the Montana statute in this case. Second, Kaiser's contracts contain choice of California law clauses that allegedly remove the protection of the Federal Arbitration Act ("FAA") based on erroneous interpretations of this Court's decision in *Volt Info. Sciences, Inc. v. Board of Trustees*, 489 U.S. 468 (1989).

Kaiser, a non-profit corporation, and its affiliates operate health maintenance organizations ("HMOs") in California and other parts of the United States. These HMOs arrange for health care services to millions of people under medical and hospital service agreements entered into with government agencies, private employers, union-management welfare funds, and individual subscribers. The basic terms of these service agreements are standard provisions that are subject to review and approval by state licensing agencies and the U.S. Department of Health and Human Services. Kaiser is regulated by the latter agency because Kaiser's HMOs are federally qualified under the federal Health Maintenance Organization Act of 1973, 42 U.S.C. § 300e, *et seq.*

The service agreements of the Kaiser HMOs in California and in several other regions of the United States include standard arbitration provisions. Kaiser's use of arbitration began in California more than twenty years ago. Kaiser's California arbitration provision, which applies to more than 4 million members, encompasses medical malpractice claims and other claims that arise from or are incident to the service agreements. The arbitration provision is governed by the FAA because the service agreements evidence transactions involving interstate commerce within the meaning of 9 U.S.C. §§ 1 and 2.

Kaiser's service agreements have for many years included two choice of law clauses that incorporate California law. The first clause ("the general clause"), which is one of several clauses under the heading "Miscellaneous Provisions," states:

> **I. Controlling Law.** This Agreement shall be governed in accord with the laws of the State of California.

The second clause ("the arbitration conduct clause"), which is found in the arbitration provision, provides:

> **E. General Provisions**. . . .
>
> * * *
>
> With respect to any matter not herein expressly provided for, arbitration shall be governed by the California Code of Civil Procedure provisions relating to arbitration that are in effect at the time the statute is applied.

In agreeing to these clauses, Kaiser never expected, much

less intended, that they would deprive Kaiser or the other contracting parties of the basic protection afforded by the pro-arbitration policies of the FAA. The purpose of the general clause has always been to have a predictable body of substantive law that would guide the parties in discerning their rights and obligations under the various provisions of the service agreements that pertain to the nature and scope of the health care services covered by the agreements, members' eligibility for this coverage, and the monetary consideration that is paid in exchange for this health care coverage.

The intended purpose of the arbitration conduct clause has been to adopt the body of procedural rules set forth in the California Arbitration Act, Calif. Code of Civ. Pro. § 1280, *et seq.*, which address a number of matters not specifically covered by the terms of the arbitration provision. These matters include: the appointment of a neutral arbitrator by the court if the parties fail to agree on a neutral (§ 1281.6); disclosures of potential conflicts of interest by proposed neutral arbitrators (§ 1281.9); the arbitrability of requests for temporary restraining orders and preliminary injunctions (§ 1281.8); the coordination of arbitrations with overlapping litigation involving parties who are not bound by the arbitration agreement (§ 1281.2(c)); the powers of the neutral arbitrator with respect to the scheduling of the hearing, issuance of subpoenas, and the admission of evidence (§§ 1281.2 & 1282.6); and the right to conduct discovery (§§ 1283.05 & 1283.1).

Since this Court's decision in *Volt, supra,* attorneys for member/claimants who contest the scope or enforceability of Kaiser's arbitration provision have begun to argue that the foregoing choice of law clauses render the FAA inapplicable. Although Kaiser maintains that the clauses are not intended to exclude the basic policies of the FAA, the dispute has so far proven to be academic because California law has generally

embraced the FAA's policies. However, the issue may soon cease to be academic in light of the California Legislature's recent enactment of section 1363.1, Calif. Health & Safety Code.

Section 1363.1, which became effective on January 1, 1995, requires that Kaiser and other California HMOs issue specified written notices of arbitration provisions in their service agreements. A prescribed notice must now appear immediately above the signature line of every service agreement, whether it be with an employer or an individual subscriber, § 1363.1. A similar notice must be given above the signature line of every enrollment form signed by individual subscribers when they enroll themselves and family members under a service agreement. *Id.*

While Kaiser has endeavored to comply with this new legislation, it is inevitable that the required notices will not be given in many instances due to circumstances beyond Kaiser's control. In the context of group plans, the enrollment forms are administered by employers or union welfare funds. Some of these organizations insist on using their own "standard" enrollment forms that do not comply with the new statute. Furthermore, many employers and union welfare funds that have contracted with Kaiser for years may mistakenly use old editions of Kaiser's own enrollment form rather than the new forms that contain the prescribed notice.

Because of the implications of § 1363.1, this case will directly affect Kaiser's reliance on arbitration as a means to achieve economical but fair resolutions of disputes with its members. For the reasons explained below, Kaiser hopes that this Court will unequivocally confirm that the FAA preempts any state law that imposes discriminatory notice burdens on the formation of valid arbitration agreements. In addition, because Kaiser prefers to continue to incorporate California law for the

purposes stated above, Kaiser urges the Court to dispel the notion that *Volt* removes the protection of the FAA whenever a contract includes a clause that incorporates state law.

II. INTRODUCTION

There are really two facets to this case. First, the Court now has a concrete opportunity to amplify the principle that the formation of arbitration agreements within the FAA's sphere must be judged on the basis of the same standards that apply to other categories of legally favored contracts.[1] To date, the Court has only alluded to this principle in footnote 9 of its opinion in *Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987) and its general characterization of the FAA as a Congressional mandate that the courts place arbitration agreements "upon the same footing as other contracts." *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 511 (1974).

The policy is straightforward: a state may not impose rules that discriminate against the enforcement of arbitration agreements. Congress favors arbitration agreements because they serve both the interests of the parties and the public. The FAA therefore enjoins courts to enforce these agreements "save upon such grounds as exist at law or in equity for the revocation of *any contract*." 9 U.S.C. § 2 (Emphasis added). The underscored words can only mean that the legal conditions that govern the creation of a valid arbitration agreement cannot be more onerous than those that govern other contracts that are favored by public policy.

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1. The parity of treatment mandated by the FAA is not judged by reference to the class of "suspect" contracts for which a state has established special disclosure requirements to protect against overreaching. Rather, arbitration agreements are to be enforced on the same terms as ordinary contracts that enjoy a comparable favored status. *Saturn Distribution Corp. v. Williams*, 905 F.2d 719, 725 (4th Cir.), *cert. denied*, 498 U.S. 983 (1990).

This basic non-discrimination policy does not impede the traditional power of a state to regulate contracts to ensure that parties with inferior bargaining power are adequately informed of what they are agreeing to. Indeed, the FAA does not even prevent a state from banning all standard form contracts if it wished to do so. The Act simply prohibits states from making an arbitration provision run a special gauntlet that does not apply to other provisions in similar contracts.

The second challenge posed by this case is the need for clarification of the holding in *Volt Info. Sciences, Inc. v. Board of Trustees*, 489 U.S. 468 (1989). *Volt* has led to growing confusion regarding the impact of choice of law clauses on the core policies of the FAA. While some courts have been circumspect in their interpretation of *Volt*, other courts have viewed the decision as a license to ignore the FAA whenever a contract contains a clause that incorporates the law of a state jurisdiction. As a result, these choice of law provisions have become loopholes by which state laws are permitted to eradicate arbitration agreements under the guise of honoring the parties' intentions.

As noted by petitioners' brief, a growing number of states have enacted statutes, similar to the Montana statute now before the Court, that impose special disclosure requirements or other conditions on the formation of arbitration provisions. The FAA is the only legal shield that protects arbitration agreements from these discriminatory statutes. Unfortunately, this protection is being questioned at every turn because many arbitration agreements are coupled with common choice of law provisions that incorporate the law of the states that have legislated against arbitration. It is therefore imperative that this Court clarify *Volt* lest the benefits of arbitration become lost in a sea of litigation over whether choice of law clauses remove a contract entirely from the FAA's protective sphere.

The franchise contract in this case, of course, does not contain a choice of law clause that incorporated Montana law. However, the Montana Supreme Court based its decision entirely on *Volt*, and this Court will therefore be required to explain *Volt's* holding and the implications of this troublesome precedent. Kaiser submits that there is a right way and a wrong way to describe how *Volt* fits into the framework of federal arbitration law.

The wrong way is to distinguish *Volt* merely on the ground that the contract here did not incorporate Montana law. This approach is fraught with danger because it will be widely construed as a signal that the non-discrimination policy of the FAA can be easily overridden by a choice of law clause. The federal policy would prevail in this case but only by becoming extinct in numerous other cases involving contracts that select the law of a state that enacts a discriminatory notice statute.

Kaiser urges the Court to seize this opportunity to clarify that *Volt* stands for the proposition that a state court has wide latitude in determining whether a choice of law clause was intended to adopt state procedural rules that are designed to aid the practical implementation of arbitration agreements. The Court should also endorse the converse of this principle: if a state law would prevent the formation of a valid arbitration agreement, there must be very compelling evidence to overcome the presumption that the contracting parties did not intend to select any rule of law that would nullify their agreement. This presumption applies because the interpretation of a choice of law clause, insofar as it affects the parties' arbitration agreement, is ultimately governed by the FAA's standard that resolves all doubts in favor of arbitration.

III. *VOLT'S* CONFUSING LEGACY

The result reached in *Volt* is difficult to criticize. A California court construed a general choice of law clause as incorporating the procedural rules of the California Arbitration Act, a statute that is animated by the same pro-arbitration policy as evinced by the FAA. *See Madden v. Kaiser Foundation Hospitals*, 17 Cal. 3d 699, 706-07, 131 Cal. Rptr. 882 (1976).

The California rules did not invalidate the parties' arbitration agreement. They simply supplied a procedural mechanism for resolving the practical problem of how to coordinate an arbitration with an overlapping lawsuit involving parties who are not subject to arbitration. Thus, the majority in *Volt* correctly observed that the state court's interpretation of the choice of law clause was fully consistent with the core policies of the FAA.

A very different problem arises when a choice of law clause is deemed to incorporate a state law that nullifies the very arbitration agreement that the parties made, thereby jettisoning the FAA entirely. A growing number of courts have reached this conclusion on the mistaken belief that it is condoned, if not compelled, by *Volt*.

In *Rhodes v. Consumers' Buyline, Inc.*, 868 F. Supp. 368, 372-74 (D. Mass. 1993) and *Armco Steel Co., L.P. v. CSX Corp.*, 790 F. Supp. 311, 318-19 (D.D.C. 1991), the district courts concluded that defenses based on the alleged illegality of an entire commercial contract containing an arbitration provision were not arbitrable based on state rules of arbitrability. These rules, which reserve such issues for the courts, are directly contrary to this Court's holding in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 402-04 (1967), which requires

that a revocability defense directed at an entire contract, and not just the arbitration provision thereof, be referred to arbitration.

The *Rhodes* and *Armco* courts discarded the FAA by a mechanical syllogism: (a) the contract contains a choice of state law clause as in *Volt;* (b) ergo, the parties must have agreed to abandon the FAA and its liberal policy of arbitrability.

The decision of the Texas Court of Appeals in *American Physicians Service Group v. Port Lavaca Clinic Associates*, 843 S.W. 2d 675 (Tex. App. 1992) is another illustration of how *Volt* has been transformed into an unwitting device for evading the FAA. The court held that an arbitration provision was void because it was not specially highlighted as required by a Texas statute that imposed this technical requirement only on arbitration agreements. *Id.* at 677-78. Paying no heed to the core policies of the FAA, the court reasoned that the parties chose this discriminatory rule over the FAA because of a choice of law clause that stated:

> [A]ll controversies . . . shall be determined, to the extent consistent with federal and state law, by arbitration, to be held . . . pursuant to the arbitration laws of the State of Texas. . . .

Id. at 676. *Volt* was the cited authority for this "consensual" destruction of the arbitration agreement. *Accord, Albright v. Edward D. Jones & Co.*, 571 N.E. 2d 1329 (Ind. App. 1991), *cert. denied*, 506 U.S. 818 (1992).

Perhaps the most extreme interpretation of *Volt* as an exit from the FAA is *Yates v. Doctor's Associates, Inc.*, 193 Ill. App. 3d 431, 549 N.E. 2d 1010 (Ill. App. 1990). The court held that a franchisor had waived its right to arbitration by affirmatively seeking judicial relief on the merits in the state courts. Although

this conclusion could easily have been grounded on FAA precedents[2], the court elected to rely on Illinois law because it found that the franchisor had impliedly consented thereto by basing its motion to compel arbitration on the Illinois Uniform Arbitration Act. This implied abandonment of the FAA was predicated on the court's belief that *Volt* applied "with equal force" to the facts before it. *Id.* at 1016.

Yates is disturbing in that it demonstrates that *Volt* can be construed as calling for a forfeiture of FAA protection if the proponent of arbitration simply relies on a state arbitration statute as the procedural vehicle for compelling compliance with the arbitration agreement. This interpretation is irreconcilable with *Southland Corporation v. Keating*, 465 U.S. 1, 10-16 (1984) in which the Court held that the core policies of the FAA are fully applicable to proceedings to enforce arbitration rights in state court.

Not all courts have accepted the simplistic view that *Volt* allows courts to turn a deaf ear to the FAA whenever a contract contains a choice of state law clause. A number of courts have refused to construe ambiguous choice of law clauses as evidencing an intent to opt out of the FAA, especially when the allegedly "chosen" state law is inimical to arbitration.[3] However, as shown by the foregoing, there is mounting evidence

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2. *E.g., Zwitserse Maatschappij v. ABN Int'l Capital Markets Corp.*, 996 F.2d 1478, 1480 (2nd Cir. 1993) (waiver by filing action to obtain discovery not available in arbitration).

3. *E.g., Todd Shipyards Corp. v. Cunard Line*, 943 F.2d 1056, 1061-62 (9th Cir. 1991); *Ackerberg v. Johnson*, 892 F.2d 1328, 1333-34 (8th Cir. 1989); *Seymour v. C[illegible]'s Coffee*, 732 F. Supp. 988, 992-95 (D. Minn. 1990); *Merrill Lynch, [illegible] et al. v. Shaddock*, 822 F. Supp. 125, 133-37 (S.D.N.Y. 1993); *Osteen v. T.E. Cuttino Constr. Co.*, 434 S.E. 2d 281, 283-84 (S.C. 1993); *Dowd v. First Omaha Securities Corp.*, 495 N.W. 2d 36, 41 (Neb. 1993).

that, contrary to the Court's intent, *Volt* is often used to turn contract interpretation into a means for reviving "the ancient suspicion of arbitration." *Securities Industry Ass'n v. Connolly*, 883 F.2d 1114, 1119 (1st Cir. 1989), *cert. denied*, 495 U.S. 956 (1990).

IV. THE INTERPRETATION OF CHOICE OF LAW PROVISIONS BY BOTH FEDERAL AND STATE JUDGES IS SUBJECT TO THE FAA'S CORE POLICIES

Because the FAA does not compel parties to enter into arbitration agreements, one cannot rule out the possibility that the parties to an arbitration agreement might agree to remove the agreement entirely from the FAA's protection. There are two key issues, however, that beg clarification. Is the interpretation of this intent a matter of federal law? If so, what is the federal rule of interpretation?

Regarding the first issue, the Court has clearly indicated that the pro-arbitration policy of the FAA must be honored when a federal court construes the meaning of a choice of law clause in proceedings to compel arbitration or to vacate arbitral awards brought in federal court under the FAA. In *Mastrobuono v. Shearson Lehman Hutton, Inc.*, __ U.S. __, 115 S. Ct. 1212 (1995), the Court rejected the argument that a general choice of New York law clause necessarily meant that the parties agreed that arbitrators could not award punitive damages. The Court resolved the obvious ambiguity of the choice of law clause in favor of allowing punitive damages because there was evidence that the arbitration provision was intended to confer full remedial authority on the arbitrator. In doing so, the Court relied primarily on the core policy of the FAA that requires that all doubts be resolved in favor of arbitration. *Id.* at 1218 & n.8.

Although in *Mastrobuono* the Court examined the parties'

intent as a matter of federal law, a footnote to the majority opinion suggests that in *Volt* the Court was constrained to accept the state court's interpretation of the choice of law clause because " 'the interpretation of private contracts is ordinarily a question of state law, which this Court does not sit to review.' " *Id.* at 1217 n.4 (quoting from *Volt*, 489 U.S. at 474.) Insofar as this comment means that a state court may construe the parties' intent without regard for the FAA, it is quite incorrect.

The action in *Mastrobuono* was based on "a variety of state and federal law theories." *Id.* at 1214. Normally, a federal court decides a pendent state law claim based on the applicable state law. Yet, this Court resolved the arbitrability issue as to both the federal and pendent state law claims as a matter of federal law. It logically follows that had the same arbitrability issue been raised in state court, the state court would likewise be subject to the overriding federal standard of interpretation because the agreement was within the purview of the FAA.

That the FAA creates an overarching federal standard is also borne out by *Prima Paint, supra.* There, the Court held that in a pure diversity case, the FAA policy of arbitrability applies as a matter of federal law. 388 U.S. at 402-05. Later, in *Southland Corporation v. Keating, supra,* the Court confirmed that the FAA remains paramount even with respect to issues of arbitrability that arise in state court proceedings. 465 U.S. at 10-16.

Thus, while the application of the premise of Justice Brennan's dissent in *Volt* may be debatable in a given case, the premise itself is indisputable: a state court's interpretation of a choice of law clause must comport with the core policies of the FAA. The *Volt* majority also embraced this premise since the majority emphasized that the state court's interpretation of the choice of law clause did not offend the FAA. 489 U.S. at 476. The Court has followed the same principle when reviewing other

state court decisions concerning private contracts that are subject to overriding federal standards. *E.g., Swarb v. Lennox,* 405 U.S. 191 (1972) (federal constitutional standard governs whether debtors agreed to confession of judgment procedure).

In some cases, like *Volt,* in which the state court rules in question reflect a pro-arbitration policy, there ordinarily is no need to upset a state court's interpretation of the purpose and scope of a choice of law clause. However, when the allegedly chosen state rule precludes or impairs the formation or enforceability of an arbitration provision, courts must construe the contract with a "healthy regard for the federal policy favoring arbitration." *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.,* 473 U.S. 614, 626 (1985), *quoting Moses H. Cone Memorial Hospital v. Mercury Construction Corp.,* 460 U.S. 1, 24-25 (1983). This rule of interpretation proceeds from the presumption that the parties did not intend to incorporate a state law that nullifies or impairs their arbitration agreement. If "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration. . . .", *Moses H. Cone, supra,* 460 U.S. at 24-25, surely the same "all doubts" presumption must apply when a claim is made that the parties to an arbitration agreement intended to adopt rules that challenge or defeat the very existence or validity of their agreement.

By clearly declaring that choice of law issues are governed by the "all doubts" presumption, this Court will not only end the confusion surrounding *Volt,* but it will also encourage private parties to continue to rely on state arbitration rules to implement their arbitration agreements. Many states have arbitration statutes that are not only favorable to arbitration but reflect refinements and innovations that address issues which Congress never contemplated when it enacted the FAA in 1925. *See Volt,* 489 U.S. at 476 n.5. Furthermore, because the FAA does not prescribe rules concerning the conduct of an arbitration,

Southland Corporation, supra, 465 U.S. at 11 n.6, Congress undoubtedly expected that private parties would often look to state law for guidance concerning the right to conduct discovery, the scheduling of arbitration hearings, the admissibility of evidence, and similar matters. *See* Part I above.

On the other hand, if the Court does not disclaim the unbridled interpretations of *Volt,* business organizations and other parties will be forced to rewrite their contracts to omit any sentence that might be construed as an incorporation of all state laws relating to arbitration. Indeed, if decisions such as *Yates, supra,* are heeded, a party will not even dare to base an action to compel arbitration on the local jurisdiction's arbitration statute lest a citation to the statute be deemed an implied consent to the application of all state rules, including those that are aimed at defeating arbitration. Since most actions to compel arbitration must be brought in state court where the procedural provisions of the FAA probably do not apply[4], this risk avoidance strategy can only lead the parties and state court judges into a procedural void. Thus, by affirming that choice of law clauses, as they affect arbitration, are governed by a federal rule of interpretation, the Court will ensure both a "healthy regard" for federal policy and a healthy use of the many state laws that assist the practical implementation of arbitration agreements.

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4. The FAA does not constitute an independent basis for federal question jurisdiction, *e.g., Southland Corporation, supra,* 465 U.S. at 15 n. 9, and sections 3 and 4 of the FAA appear to apply only to proceedings in federal court, *Volt,* 489 U.S. at 477 n.6.

V. CONCLUSION

On the basis of the foregoing, Kaiser urges the Court to explain *Volt* in a manner that does not fuel the mistaken view that a choice of state law provision can be construed without obedience to the *federal* rule of interpretation under which reasonable doubts are resolved in favor of arbitration. In rejecting respondents' *Volt* argument, the Court should emphasize that this case has a critical fact that was missing in *Volt: viz.* a state law that is plainly antithetical to arbitration. Given the strong presumption that the parties to an arbitration agreement intend their agreement to be enforced and not torn asunder, respondents bore the heavy burden of proving that the parties intended to incorporate a state statute that nullifies their arbitration agreement. Because this burden was not met, the decision should be reversed.

Respectfully submitted,

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